

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TEXARKANA DIVISION

STATE OF TEXAS,)	
)	
Plaintiff,)	
)	No. 5-96CV-91
VS.)	
)	
AMERICAN TOBACCO)	
COMPANY, et al.,)	
)	
Defendants.)	

**VERIFIED MOTION AND BRIEF TO ENFORCE SETTLEMENT
AGREEMENT, FOR AN ACCOUNTING, AND FOR A PRELIMINARY
INJUNCTION AGAINST DEFENDANT BROWN &
WILLIAMSON TOBACCO CORPORATION**

1. Plaintiff, the State of Texas, commenced the above styled lawsuit against numerous tobacco company defendants on March 28, 1996. Subsequently, Plaintiff and numerous defendants entered into a settlement agreement. A true and correct copy of the settlement agreement and its amendments is attached as Exhibits "A-C" and incorporated herein by reference (the "Texas Settlement Agreement").¹

2. Defendant, Brown & Williamson Tobacco Corporation ("Brown & Williamson"), is a tobacco company that is a settling defendant under the Texas Settlement Agreement.

3. This is an action brought to enforce the provisions of the Texas Settlement Agreement against Brown & Williamson. Brown & Williamson has breached the Texas Settlement

¹The Texas Settlement Agreement consists of the Comprehensive Settlement Agreement and Release (attached hereto as Exhibit "A"), the Stipulation of Amendment to Settlement Agreement and for Entry of Consent Decree (attached hereto as Exhibit "B"), and the Agreement to Amendment to Settlement Agreement (attached hereto as Exhibit "C").

Agreement by failing to accurately report the volume and market share of cigarettes which it manufactured and shipped for sale in the United States.

4. The parties have agreed that this Court has exclusive jurisdiction over the parties and the enforcement of the Texas Settlement Agreement. *See* Exhibit “A” at Comprehensive Settlement Agreement and Release, pages 3-4. The Texas Settlement Agreement expressly provides that it “shall be governed by the laws of the State of Texas.” *See* Exhibit “A” at page 28 ¶ 26.

I. FACTS

A. Star Cigarettes

5. Pursuant to the Texas Settlement Agreement, Brown & Williamson promised to pay the State of Texas both “initial payments” and “subsequent annual payments.” These payments are based upon its pro rata market share of cigarettes shipped by each of the settling defendants for domestic consumption. “Market Share” is defined in the Texas Settlement Agreement as:

a Settling Defendant’s respective share of sales of Cigarettes, by number of individual Cigarettes shipped in the United States for domestic consumption, as measured by such Settling Defendant’s audited reports of shipments of Tobacco Products provided to the U.S. Securities and Exchange Commission (“SEC”) (or, in the case of any Settling Defendant that does not provide such reports to the SEC, audited reports of shipments containing the same shipment information as contained in the reports provided to the SEC) (“Shipment Reports”)....

Exhibit “B” at pp. 5-6, ¶ 3.b.

6. In 1999 and 2000, Brown & Williamson implemented a scheme that enabled it to manipulate its market share payments by under-reporting the number of cigarettes it shipped for domestic consumption. To this end, Brown & Williamson entered into a series of contracts with Star Scientific, Inc. (“Star Scientific”) and its wholly owned subsidiary Star Tobacco and Pharmaceuticals, Inc. (“Star Tobacco”) (collectively, “Star”). These contracts included loans from Brown & Williamson to provide much of the necessary capital to fund Star’s operations, including a loan of \$13 million to finance the creation of more than 600 tobacco curing barns² and a supply agreement whereby Brown & Williamson agreed to purchase millions of pounds of tobacco from Star. A true and correct copy of relevant excerpts from Star’s SEC filings describing this relationship is attached hereto as Exhibit “D.”

7. Brown & Williamson also “agree[d] to manufacture, package and ship” Star’s designated requirements of the cigarettes for each style/brand designated in the agreement. *See* Exhibit “E” supply agreement between Brown & Williamson and Star at p. 3, ¶ 2 (*emphasis added*). This agreement led to the manufacture and shipment of billions of cigarettes to Star. Specifically, Star’s filings with the Securities and Exchange Commission show that Brown & Williamson manufactured, sold, and shipped to Star 7,503,510,000 cigarettes between 1999 and 2002 as follows: 470,388,000 cigarettes in 1999; 2,788,374,000 cigarettes in 2000; 2,252,532,000 cigarettes in 2001; and

²Brown & Williamson has a security interest in all of Star’s curing barns and in its Intellectual Property. *See* Exhibit “D.”

1,992,216,000 cigarettes in 2002. *See* Exhibit “F” “Agreement Between Star Scientific, Inc., Star Tobacco, Inc., and the Settling States” as represented on the Star Scientific.com website at pp. 1-2, ¶ 1. These cigarettes are sometimes hereafter referred to as “the Star Cigarettes.”

8. Brown & Williamson did not include the Star Cigarettes in its annual report of domestic shipments of cigarettes used to calculate the payments owed the State under the Texas Settlement Agreement. By failing to report the number of Star Cigarettes, Brown & Williamson avoided \$16,420,252 in payments owed under the Texas Settlement Agreement.

9. Calculating the annual settlement payments owed to the State by Brown & Williamson and the other Settling Defendants involves the application of a formula that incorporates several factors. Exhibit “B” at pp. 10-12, ¶ 7. The formula allocates “Market Share” to each defendant based on the volume of cigarettes shipped for domestic consumption. *Id.* at pp. 5-6, ¶ 3.b. These resulting market shares are applied to specified payment amounts that are adjusted up or down pursuant to a specified “Volume Adjustment.” *Id.* at pp. 10-12, ¶ 7 & Appendix A. An increase in the Settling Defendants’ aggregate net operating profits from domestic sales of cigarettes may result in an upward adjustment.³

³Net operating profits include restructuring charges and expenses. Exhibit “C” at Appendix A.

10. The under-reporting of cigarette shipments by Brown & Williamson had the effect both of reducing Brown & Williamson's respective market share and of increasing the downward volume adjustment applied to the payment amounts. Together, the effect was to allow Brown & Williamson to pay the State far less than it was actually owed under the terms of the Texas Settlement Agreement. Furthermore, because Star is not a signatory to the Texas Settlement Agreement, it is not subject to the financial, marketing, and other obligations set forth therein. To add insult to injury, a large number of the cigarettes shipped by Brown & Williamson were ultimately sold in the State, thereby imposing smoking related health care costs and other damages to the State.

11. Brown & Williamson knew or should have known that the Star Cigarettes should have been reported to the State since at least December 20, 2002, when it was sued for its failure to report the Star Cigarettes to the state parties to the Master Settlement Agreement ("MSA"). A true and correct copy of the MSA is attached hereto as Exhibit "G" and incorporated herein by reference. The "MSA States" (Forty-six states and six U.S. territories and possessions) asserted that the Star Cigarettes should be included in Brown & Williamson's "Market Share"⁴ calculations.

12. On June 18, 2003, Brown & Williamson and the MSA States entered into a settlement agreement entitled "Settlement Agreement Between Brown & Williamson and

⁴The MSA defines "Market Share" as a manufacturer's "respective share (expressed in a percentage) of the total number of individual Cigarettes sold in the United States, the District of Columbia and Puerto Rico" based upon tax collections and "Relative Market Share" as a manufacturer's respective share of the total number of individual Cigarettes shipped in or to those jurisdictions. See Exhibit "G" at p. 9, ¶ II(z); *Id.* at pp. 12-13, ¶ II (mm).

the Settling States with Respect to the NPM Adjustments and Star Tobacco Disputes” (the “MSA Star Settlement”). A true and correct copy of the MSA Star Settlement is attached hereto as Exhibit “H” and incorporated herein by reference. In the MSA Star Settlement, Brown & Williamson agreed to pay the MSA States over \$75 million to compensate for cigarettes previously manufactured for Star, and it agreed to include all future cigarettes manufactured for Star in the total cigarette shipments reported to the MSA States for purposes of calculating market share. *See* Exhibit “H,” MSA Star Settlement at ¶ 2.

13. Notwithstanding the lawsuit and the MSA Star Settlement, Brown & Williamson did not approach the State with information regarding the Star Cigarettes and continued to disregard the State’s requests for the information. By letters dated November 12, 2003, and December 10, 2003, the Deputy Attorney General for Litigation from the Office of the Attorney General of Texas made specific requests for information regarding the cigarettes manufactured for Star.

B. Transfer to Reynolds American, Inc.

14. On October 27, 2003, Brown & Williamson publically announced the execution of an agreement to sell its U.S. cigarette business to R.J. Reynolds Tobacco Holdings, Inc. (“RJR”). Copies of Brown & Williamson and RJR’s own press releases as well as news articles announcing and tracking the progress of this transaction are attached hereto as Exhibit “I.” An important feature of this agreement is the assignment of Brown &

Williamson's rights and obligations under the Settlement Agreement to a new corporate entity, Reynolds American, Inc.⁵ However, the Texas Settlement Agreement unambiguously restricts the assignment of the obligations assumed therein as follows:

None of the rights granted or obligations assumed under this Settlement Agreement by the parties hereto may be assigned or otherwise conveyed without the express prior written consent of all the parties hereto.

Exhibit "A" at ¶ 2. The State has made inquiries to Brown & Williamson about this transfer, including repeated inquiries as to why Brown & Williamson did not seek the State's express written consent prior to agreeing to the transfer. In addition, the State has inquired as to when Brown & Williamson would seek the State's consent. Nevertheless, Brown & Williamson has failed to seek the State's consent. Brown & Williamson's conduct in this regard illustrates that it already has or intends to consummate the transfer without the State's consent, in clear contravention of the Texas Settlement Agreement.

15. Brown & Williamson's failure to account for the Star Cigarettes and its proposed transfer to Reynolds American, Inc. illustrate a pattern of intentional disregard for its obligations under the Texas Settlement Agreement.

16. The Texas Settlement Agreement expressly provides that it "shall be governed by the laws of the State of Texas." Exhibit "A" at p. 28, ¶ 26.

⁵Brown & Williamson has confirmed that it agreed to transfer its rights and obligations under the MSA, Texas, Mississippi, Florida, and Minnesota settlement agreements; that is, under all of the state tobacco settlement agreements.

II. BREACH OF THE SETTLEMENT AGREEMENT

17. The State of Texas reasserts and alleges the facts contained in the preceding paragraphs.

A. The Star Cigarettes

18. Brown & Williamson willfully breached the Texas Settlement Agreement by reporting its annual Market Share without including the number of cigarettes shipped for domestic consumption pursuant to the contract with Star and not paying the State for the Star Cigarettes.

B. The Transfer to Reynolds American, Inc.

19. Brown & Williamson has breached or has anticipatorily breached the Texas Settlement Agreement by agreeing to transfer its rights and obligations under the Texas Settlement Agreement to Reynolds American, Inc. without the State's prior written consent.

C. Damages for Breach of Contract

20. The State of Texas has suffered damages of at least \$16,420,252 as a result of Brown & Williamson's failure to include the Star Cigarettes in its Market Share calculations. A table supporting the State's damage calculations is attached hereto as Exhibit "J." The extent of the financial damage to the State resulting out of Brown & Williamson's entering into the agreement to transfer its obligations under the Texas Settlement Agreement has not yet been calculated. The State of Texas is also entitled to

recover its reasonable attorneys' fees, expenses, and costs incurred as a result of Brown & Williamson's breach of the Texas Settlement Agreement. *See* TEX. GOV'T CODE §402.006 (Vernon 1999). Further, the State is entitled to recover prejudgment and postjudgment interest.

21. The State is also entitled to a declaration that Brown & Williamson has breached the Texas Settlement Agreement. *See* Tex. Civ. Prac. Rem. Code §§ 37.001 *et. seq.* The Texas Settlement Agreement constitutes an enforceable contract entered into between the State and Brown & Williamson. The State has fully performed its obligations under the Texas Settlement Agreement. Brown & Williamson has breached the Texas Settlement Agreement by failing to report and pay the State for the Star Cigarettes and by entering into a contract to transfer its rights and obligations under the Texas Settlement Agreement without the State's express prior written consent. All pre-requisites to recovery have been met. As a result, the State is entitled to damages, attorneys' fees, expenses, costs, prejudgment and postjudgment interest.

III. ACCOUNTING

22. Through its longstanding intentional failure to report the Star Cigarettes, Brown & Williamson has established a track record of understating its Market Share to avoid payments due to the State under the Texas Settlement Agreement. Brown & Williamson is a subsidiary of a British corporation, British American Tobacco, P.L.C., and thus it does not file any relevant reports with the Securities and Exchange Commission. Under

the circumstances, the only way for the State to be certain of whether or not Brown & Williamson has failed to report the shipment of other cigarettes for domestic consumption is through an independent accounting of the financial obligations owed to the State by Brown & Williamson.

23. Under Texas law, an equitable accounting is proper under the following circumstances: (1) when there is a close fiduciary relationship between the parties; (2) when there are mutual accounts between parties to which both have contributed; or (3) when the accounts are not mutual but are complicated and difficult. *Richardson v. First Nat'l Life Ins. Co.*, 419 S.W.2d 836, 838 (Tex. 1967). Since *Richardson*, courts have held that in order to be entitled to an accounting, a party usually must have either a contractual or fiduciary relationship with the party from which the plaintiff seeks the accounting. *Hunt Oil Co. v. Moore*, 656 S.W.2d 634 (Tex. App.-Tyler 1983, reh'g denied); *T.F.W. Management, Inc. v. Westwood Shores Property Owners Ass'n.*, 79 S.W.3d 712, 717 (Tex. App.-Houston 2002, reh'g overruled). As with any equitable remedy, the party seeking the accounting must also show that it cannot obtain adequate relief at law. *Richardson*, 418 S.W.2d at 838.

24. Here, an equitable accounting is appropriate because the Texas Settlement Agreement creates a contractual relationship between the parties. Additionally, the Texas Settlement Agreement creates a close fiduciary relationship between the parties, at a minimum, with regard to the accurate reporting of Market Share. In addition, the

accounts are not mutual but are complicated and difficult, especially in light of the billions of cigarettes manufactured and shipped annually by Brown & Williamson and the intertwined nature of its relationship with Star.

25. There is no adequate relief at law without an accounting. In light of Brown & Williamson's conduct, if the State does not obtain an independent accounting of Brown & Williamson's financial obligations to the State under the Texas Settlement Agreement, it may never know the extent of Brown & Williamson's under reporting of the amounts it owes to the State. Brown & Williamson's history of withholding and misrepresenting this information, coupled with the fact that there is presently no independent verification of Brown & Williamson's financial representations, has created a situation where equitable remedies are required. In light of its repeated conduct which has created the necessity for an independent accounting, the State requests that the Court order that Brown & Williamson bear all costs associated with the accounting.

26. In the alternative, the State requests that the court appoint a Master pursuant to Federal Rule of Civil Procedure 53 for the purpose of conducting an accounting at Brown & Williamson's expense. FED. R. CIV. P. 53 provides in relevant part:

[u]nless a statute provides otherwise, a court may appoint a master only to ... hold trial proceedings and make or recommend findings of fact on issues to be decided by the court without a jury if appointment is warranted by ... the need to perform an accounting or resolve a difficult computation of damages.

FED. R. CIV. P. 53(a). Under the circumstances, an accounting is the only way the State can be certain of the extent of the damages caused by Brown & Williamson.

IV. INJUNCTION

27. Brown & Williamson's failure to seek the State's prior written consent to the transfer of its obligations under the Texas Settlement Agreement raises serious concerns about whether Brown & Williamson's contractual obligations will continue to be honored by it and if they will be honored by its purported assignee, a newly formed entity. The State is entitled to a preliminary injunction prohibiting the transfer of Brown & Williamson's rights and obligations under the Texas Settlement Agreement until such time that Brown & Williamson provides the State with the documents pursuant to which the transfer is to be made, the State has sufficient opportunity to evaluate the transfer, and the State has the opportunity to exercise its contractual right to consent or object to the transfer.

28. In order to obtain a preliminary injunction, the State must show:

- A. there is a substantial likelihood that the Plaintiff, State of Texas, will prevail on the merits;
- B. there is a substantial threat that irreparable injury will result if the injunction is not granted;
- C. the threatened injury outweighs the threatened harm to defendant; and
- D. granting the preliminary injunction will not disserve the public interest.

FED. R. CIV. P. 65; *Canal Auth. of Florida v. Callaway*, 489 F.2d 567, 572 (5th Cir. 1974), *reh. denied* (1974).

29. As set forth above, the State is substantially likely to succeed on the merits.

Brown & Williamson's own documents reflect that it entered into an agreement to transfer its rights and obligations under the Texas Settlement Agreement without obtaining the State's prior written consent. The State clearly has a contractual right to consent to the transfer before it occurs.

30. There is a substantial threat that irreparable injury will result if the injunction is not granted. The State of Texas will suffer irreparable harm if Brown & Williamson is not enjoined because Texas has a contractual right to expressly consent to the transfer before it occurs. Brown & Williamson has already contractually agreed to transfer its rights and obligations under the Texas Settlement Agreement without the prior written consent of the State. The proposed transfer has already and will continue to adversely affect the rights and privileges of the State and, without an injunction, Brown & Williamson may continue to adversely effect the State's rights under the Texas Settlement Agreement. These include many non-financial and financial obligations in favor of the State. As merely two examples, Brown & Williamson is obligated to not advertise cigarettes to the children of Texas and its product placement is severely restricted. Exhibit "B" at pp. 19-20, ¶¶ 14-15. Furthermore, pursuant to the Texas Settlement Agreement's "Most-Favored Nation" clause, Texas is also entitled to the benefit of non-financial and financial

obligations of Brown & Williamson under settlements subsequent to the Texas Settlement Agreement. *See* Exhibit “A” at pp. 9-11 at ¶¶ 6-7.

31. The threatened injury to the State outweighs the threatened harm to Brown & Williamson. Requiring Brown & Williamson to live up to its contractual obligations can in no way been seen as a “threatened harm”. On the other hand, as set forth above, the State is threatened by substantial injury. Accordingly, no bond should be required of the State. FED. R. CIV. P. 65; *Kaepa, Inc. v. Achilles Corp.*, 76 F.3d 624, 628 (5th Cir. 1996).

32. Granting the preliminary injunction will not disserve the public interest. On the contrary, granting the preliminary injunction will serve the public interest of the more than 25 million citizens of the State of Texas that benefit from the Texas Settlement Agreement.

PRAYER

WHEREFORE, PREMISES CONSIDERED, the State of Texas respectfully prays that the Court:

1. Award it damages in at least the amount of \$16,420,252, reasonable attorneys’ fees, expenses, costs, prejudgment interest, and postjudgment interest;
2. Order an independent accounting of the financial obligations owed to the State by Brown & Williamson at Brown & Williamson’s expense;

3. Enter a preliminary injunction prohibiting any transfer of Brown & Williamson's rights and obligations under the Texas Settlement Agreement until such time that Brown & Williamson provides the State with the documents pursuant to which the transfer is to be made, the State has sufficient opportunity to evaluate the transfer, and the State has sufficient opportunity to exercise its contractual right to consent or object to the transfer; and
4. Award such other and further relief, both general and special, at law and in equity, to which the State of Texas may be justly entitled.

Respectfully submitted,

GREG ABBOTT
Attorney General of Texas

BARRY R. McBEE
First Assistant Attorney General

EDWARD D. BURBACH
Attorney-In-Charge
Deputy Attorney General for Litigation
State Bar No. 03355250
P.O. Box 12548
Austin, Texas 78711-2548
Telephone: (512) 936-1886
Telecopier: (512) 463-2063

LINDA SHAUNESSY
Assistant Attorney General
State Bar No. 10382920
P.O. Box 12548
Austin, Texas 78711-2548
Telephone: (512) 475-1652
Telecopier: (512) 477-2348

Attorneys for Plaintiff, The State of Texas

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Plaintiff's *Verified Motion and Brief to Enforce Settlement Agreement, for an Accounting, and for a Preliminary Injunction Against Defendant Brown & Williamson Tobacco Corporation* has been served via certified mail, return receipt requested on the 27th day of May, 2004.

James N Haltom
Patton Haltom Roberts
McWilliams & Greer LLP
2900 St. Michael Dr Ste 400
Texarkana TX 75505-6128

Thomas E Fennell
Jones Day
2727 N Harwood St
Dallas TX 75201-1515

Nicholas H Patton
Patton & Tidwell
4605 Texas Blvd
PO Box 5398
Texarkana TX 75505-5398

Dan K Webb
Winston & Strawn
35 W Wacker Dr
Chicago IL 60601

Robert A Gwinn
Gwinn & Roby
1201 Elm
4100 Renaissance Tower
Dallas TX 75270

Bruce Ginsberg
Davis & Gilbert
1740 Broadway
New York NY 10019

Paul Edward Stallings
Vinson & Elkins
1001 Fannin St Ste 2300
Houston TX 77002-6760

Alan David Harrel
Atchley Russell Waldrop & Hlavinka
PO Box 5517
1710 Moores Lane
Texarkana TX 75505-5517

Damon Young
Young Pickett & Lee
4122 Texas Blvd
PO Box 1897
Texarkana TX 75504-1897

Jerry L Mitchell Jr
Kasowitz Benson Torres & Friedman LLP
700 Louisiana St Ste 2200
Houston TX 77002

Winford L Dunn Jr
Dunn Nutter & Morgan
State Line Plaza Box 8030
Ste Six
Texarkana AR 71854-5945

William Key Wilde
Bracewell & Patterson
711 Louisiana Ste 2900
Houston TX 77002-2781

LINDA SHAUNESSY